Opening China's Market to U.S. Agriculture

by Loraine A. West

Between 1986 and 1993, the United States merchandise trade deficit with China increased from $1.7 billion to a record $22.8 billion, and now is second only to the U.S. deficit with Japan. The U.S. agricultural trade surplus with China also vanished over this period. The United States hopes the market access agreement reached with China in 1992 will reverse the trend of rising deficits. What prompted this agreement? What reforms does the new agreement set forth and how might our agricultural trade with the giant Chinese market be affected?

The United States blames much of the worsening trade balance on the proliferation of China's trade barriers starting in the latter half of the 1980s: import bans, quotas, licenses and prohibitive tariffs of 100–200 percent. At the same time, the United States became one of China's main export markets, especially for textile products and light manufactured goods.

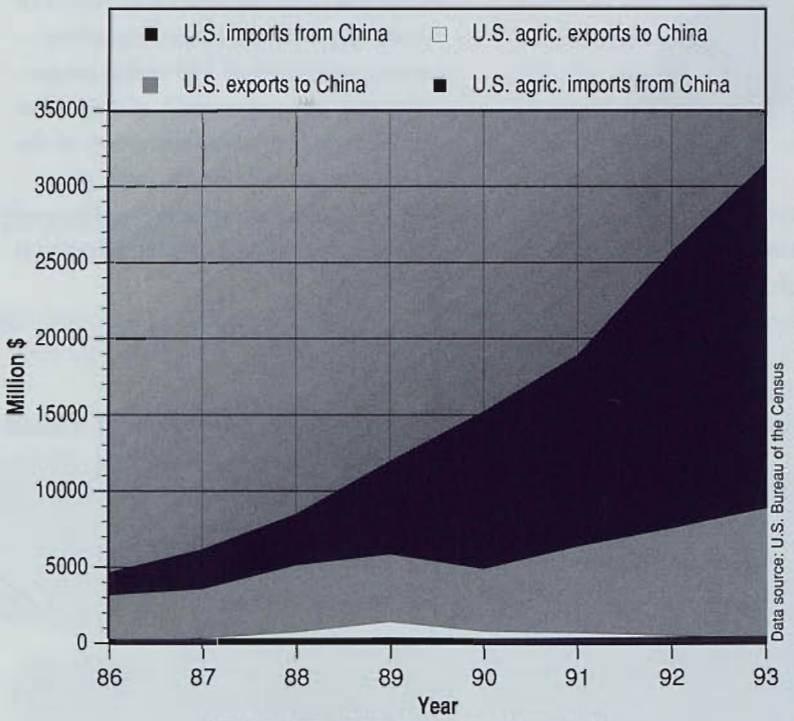

Figure 1. U.S.-China total agricultural trade

In October 1991, rising trade deficits led the U.S. government to launch an investigation of market access barriers maintained by China. Negotiations to resolve the trade dispute concluded on October 10, 1992, when both governments signed a Memorandum of Understanding on market access.

The memorandum singles out specific trading practices hindering U.S. exports. It also lists products for which U.S. companies have established markets elsewhere in the world and which have good sales prospects in China. The agreement covers a wide range of goods including a number of agricultural products, such as wheat, soybean oil, tobacco, and fruit, and it aims to reverse the decline in agricultural exports to China (figure 1).

All five major provisions of the memorandum may help U.S. agricultural exports. In the first provision, China committed to a more transparent trade system through publication of all trade-related laws and regulations. Formerly, many trade laws and regulations were state secrets or for internal use only. Information on import licenses requirements, for example, was difficult to obtain. China now publishes some of this information in designated newspapers, but has yet to establish a comprehensive list of laws and regulations.

China also pledged to renounce import substitution as a development strategy. Policies that favored import substituting firms, such as tax rebates and preferential access to foreign exchange, are to be discontinued. The government eliminated preferential access to foreign exchange at the beginning of 1994 when China abandoned the dual exchange-rate system by unifying the official and swap mar-

ket rates.

Another major provision calls for China to eliminate all import nontariff restrictions, including quotas, licenses, and controls for a specific list of product categories according to a set time schedule. Nearly 75 percent of these nontariff import restraints are to be removed by the end of 1994, although the schedule continues until the end of 1997 for some products.

China is to revise all sanitary and phytosanitary standards and testing requirements, making them scientifically justifiable. This provision especially affects U.S. exports of plant products and animal breeding stock.

Finally, China agreed that by 1993 it would significantly reduce tariffs raised since 1988 for various commodities including fruits, nuts, food preparations, and vegetable oils.

While it is still too early to fully evaluate the impact of these trade liberalization measures on China's economy and U.S. exports, some indicators suggest what may happen.

Fruit

China has long maintained a ban on U.S. fruit, except for small quantities imported by joint venture hotels catering to foreigners. Officially, the Chinese fear diseases and pests, especially the medfly. The standards and testing provision of the memorandum questions the basis for the ban and led to consultations and scientific exchanges between the Animal and Plant Health Inspection Service (APHIS) of the USDA, and China Animal and Plant Quarantine (CAPQ) of the Ministry of Agriculture. As a result of these exchanges, China agreed in December 1993 to allow imports of Washington State apples from approved orchards and packing houses. The first shipment of apples arrived in Shanghai in July. China continues to ban imports of California apples and citrus because of the medfly. Negotiations are underway to revise standards for stone fruit and grapes. Quotas on fruit were removed and tariffs lowered effective January 1, 1994. The tariff on apples, for example, fell from 80 to 40 percent.

In spite of the historical ban, U.S. fruit was widely available in China's urban markets for the past several years. U.S. grapes, Sunkist oranges, and Washington State apples are common in the southern province of Guangdong. Official U.S. exports of fresh fruit to China, however, have been minimal and declining in recent years. But at the same time, U.S. fresh fruit exports to Hong Kong rose and reached a record $131.5 million in 1992. Traders then re-export to China a portion of U.S. fruit exported to Hong Kong. The transhipment of U.S. fruit through Hong Kong, whether smuggled or

official, now accounts for the majority of U.S. fruit consumed in China. The U.S. agricultural trade office in Guangzhou estimates that the Chinese already consume $10 million of U.S. fresh fruit annually, an amount equal to about 2 percent of all U.S. agricultural exports to China.

Rising income levels have led to improved diets for Chinese consumers and increased demand for fruit. Urban consumption of fresh fruits and melons rose from 32 kilograms per capita in 1985 to 41 kilograms in 1991. Rural consumption also rose but still lags behind urban levels. Increased consumption of fruit comes from both expanded domestic production and imports.

According to Chinese agricultural officials, the effect of removing trade barriers on Chinese fruit growers will be modest because the market for high-quality imported fruit is still limited. A large share of Chinese consumers will continue to purchase cheaper, domestically produced fruit. Shandong apple growers, however, will be most affected because they produce higher-quality fruit that would compete with U.S. apple exports. Once China implements provisions of the trade memorandum, U.S. and Chinese traders believe ample opportunity exists for expanded sales of U.S. fruit, especially in the major urban centers of Beijing and Shanghai.

Grains

Under the Memorandum of Understanding, China will lift grain import quotas by the end of 1994. According to Chinese officials, trade liberalization will affect wheat trade more than trade of other grains. Phytosanitary restrictions, which prevented the import of U.S. wheat from the Northwest because of a potential TCK smut problem, are to be revised and based only on objective scientific standards. At the end of 1993, China agreed that wheat containing TCK spores would be accepted for de-

livery in Hainan, China's southernmost province. It is believed the spores cannot survive in that climate and would not pose a threat to China's wheat production in the north.

Historically, the U.S. has been one of China's major wheat suppliers; wheat accounts for 50 percent or more of U.S. agricultural exports to China. In 1989, the U.S. supplied 50 percent of China's wheat imports, but in recent years the share has declined to about 30 percent. U.S. wheat sales to China fell from $1.1 million in 1989 to only $274,000 in 1992. It is hoped that these trade provisions will reverse this trend. In its favor, imported U.S. wheat reportedly yields 7-8 percent more flour than domestic wheat, and imported wheat often sells at a lower price than domestic wheat.

As China's corn production and exports increased in recent years, U.S. corn sales to China fell dramatically. From 1987 to 1992, China's corn production increased at nearly 4 percent per year while exports increased at 19 percent per year. Most of China's corn exports went to South Korean and Japanese markets. U.S. agricultural officials believe that in the future when China's existing grain stocks fall, corn sales to southern China may increase. The existence of a large livestock industry in the south and a congested transport system in China can make U.S. corn imports attractive.

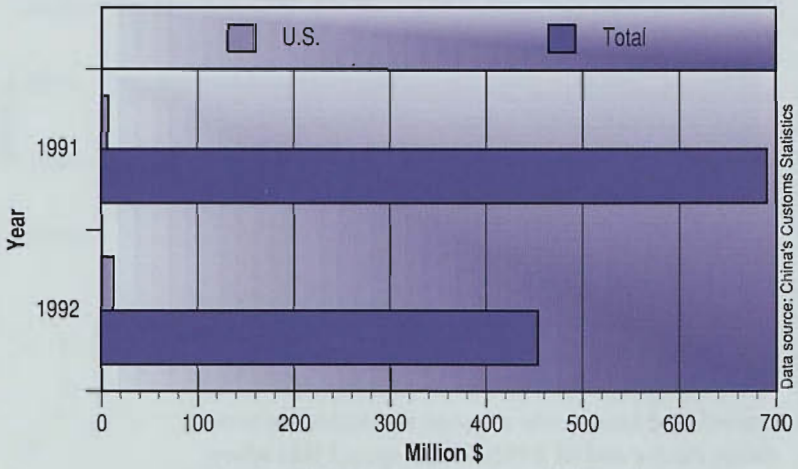

Figure 2. China's total and U.S. vegetable oil imports

Vegetable oils

China reduced tariff levels for vegetable oils at the end of 1993. The soybean oil tariff dropped from 20 to 13 percent. The memorandum also calls for the removal of quotas by the end of 1995.

The impact of trade liberalization on China's domestic vegetable oil production will be substantial. Chinese sources report that, even under previous tariff rates, the cost of imported vegetable oil is still lower than domestic oil. Furthermore, the quality of imported oil is much higher.

Rising living standards allowed consumers to substitute vegetable oil for animal lard in their diets. From 1985 to 1991, rural and urban per capita consumption of vegetable oil increased by 48 percent and 20 percent, respectively. Future total consumption may increase substantially because rural per capita consumption is less than 60 percent of urban consumption and over 70 percent of the population lives in rural areas. Indirect consumption of vegetable oil is also rising with the increase of processed foods in the diet.

China's vegetable oil imports averaged 1.7 million tons per year between 1989 and 1992. However, the U.S. value share of this large market reached a maximum of only 3 percent in 1992 (figure 2). China uses most vegetable oil imports in the food processing industry, primarily importing relatively inexpensive palm oil for this purpose. In the latest round of tariff cuts for vegetable oils, China also slashed the rate for palm oil to nearly half. Consequently, the increase in U.S. vegetable oil exports to China after the removal of trade barriers may be modest and the share of vegetable oils in U.S. agricultural exports to China may remain minor.

Tobacco

Phytosanitary restrictions concerning possible blue mold have prohibited U.S. tobacco leaf exports to China. The U.S. does not view tobacco blue mold as a problem and hopes through scientific exchanges to convince China to lift the restrictions. The memorandum also eliminates import licenses for tobacco and tobacco products by the end of 1994.

U.S. tobacco leaf competes in the European and Russian markets and U.S. agricultural trade officials believe sales to China will increase once China bases phytosanitary restrictions on sound science.

Currently, cigarettes dominate U.S. tobacco and tobacco products exports to China. In addition, traders re-export a large volume of U.S. cigarettes from Hong Kong to China. Chinese customs reports that cigarettes are one of the top goods smuggled into China. Smuggling may partially explain why U.S. exports and Hong Kong re-exports of tobacco and tobacco products exceeded China's trade statistics for total imports in 1989 and 1990 (figure 3).

Impending trade liberalization will benefit Chinese consumers who have a preference for high-quality tobacco and imported cigarettes. The impact on Chinese production is complicated by the government's monopolized control of production and marketing of tobacco and cigarettes. Tobacco and cigarette taxes provide more tax revenue than any other single source.

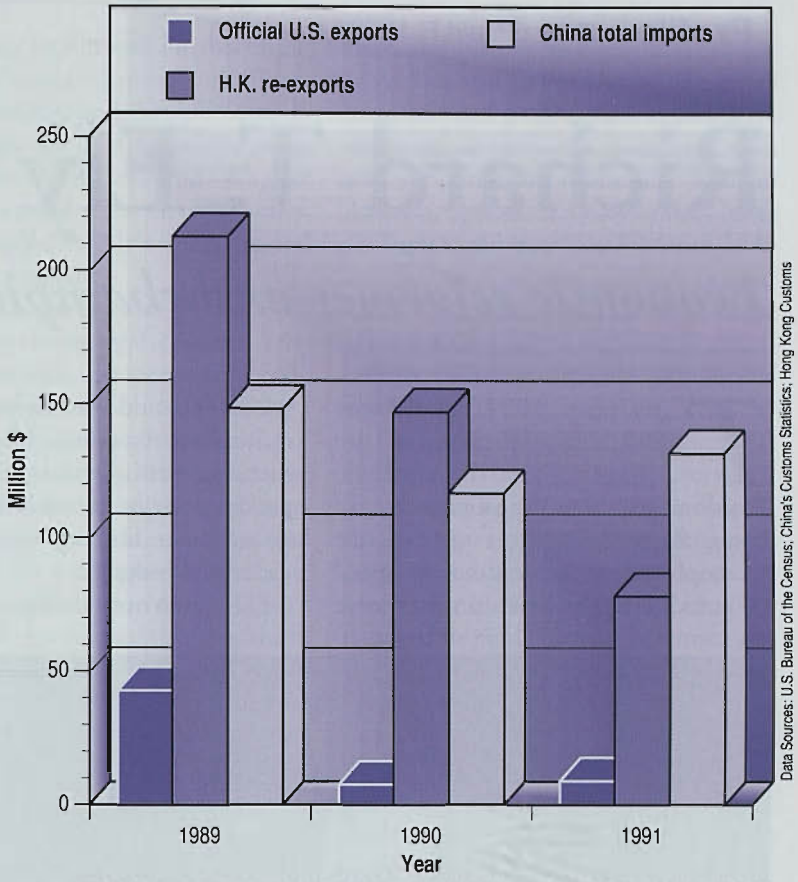

Figure 3. Tobacco and tobacco products: official U.S. exports, Hong Kong re-exports, and China total imports, 1989-1991

Accessing China's vast market

Trade liberalizing reforms undertaken by China in the Memorandum of Understanding will not only help ease trade tensions between China and the U.S., but will also advance China's petition to rejoin the General Agreement on Tariffs and Trade (GATT). The high priority China's leaders place on GATT membership may encourage a more comprehensive implementation and enforcement of memorandum reforms.

Dismantling trade barriers will open China's market to U.S. exporters as well as to exporters from other countries. While U.S. companies and products must compete against others in China's more open market, strong consumer preference for U.S. goods bodes well for U.S. exports. The USDA Foreign Agricultural Service reports that Chinese appreciate imported U.S. foodstuffs. Continued growth in China's economy will allow further increases in per capita consumption of quality food products. Presently, China accounts for less than 2 percent of total U.S. agricultural exports. However, China potentially rivals Taiwan as the third major Asian market behind Japan and South Korea for U.S. agricultural exports. Increased access to China's vast consumer market offers challenges and benefits to exporters of U.S. agricultural products. ◘

Schedule for removal of trade barriers

Agricultural Product	Trade Barriers	Action	Date
Fruit			
oranges, lemons, limes, grapefruit, grapes, raisins,	Quotas	Remove	12/1993
melons, apples, pears, cherries, plums, strawberries	Standards & Testing	Revise	10/1993
	Tariffs	Reduce	12/1993
Grains			
wheat, rye, barley, oats, corn, rice, sorghum,	Quotas	Remove	12/1994
buckwheat, millet, canary seed	Standards & Testing	Revise	10/1993
Edible Vegetable Oils			
refined soybean, sunflower/safflower, and corn oils	Quotas	Remove	12/1994
	Tariffs	Reduce	12/1993
crude soybean, sunflower/safflower, and corn oils;	Quotas	Remove	12/1995
crude and refined peanut, cottonseed and jojoba oils	Tariffs	Reduce	12/1993
Tobacco and Tobacco Products			
cigars, cheroots, cigarillos, and cigarettes	Licenses	Remove	12/1994
containing tobacco; smoking tobacco	Standards & Testing	Revise	10/1993

Loraine A. West is an economist at the Center for International Research, Bureau of the Census, United States Department of Commerce.